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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF NATIONAL COAL ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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INTEREST OF AMICUS CURIAE

The National Coal Association ("NCA") is a trade association comprising approximately 200 members. Its coal producing members account for over 50 percent of the nation's coal production. In addition to coal producing companies, the National Coal Association's membership includes coal brokers, equipment suppliers, coal transporters, consultants, and resource developers.

Most of NCA's members are public companies subject to the financial reporting requirements of the federal securities laws. A number of NCA's members have their principal offices in, and/or conduct operations in, states

within the Fifth Circuit. Others have offices and/or operations in states within federal circuits whose decisions conflict with the decision below.

Regardless of where their offices or operations are located, all of NCA's public company members are affected by the uncertainty in the law arising from the inability of the courts of appeal to agree concerning the issues here involved. These companies must prepare, or have their outside accountants prepare, tax pool analyses so that their financial statements can be certified. The question whether, and under what circumstances, the Internal Revenue Service ("IRS") can summon these tax pool analyses pursuant to 26 U.S.C. § 7602 thus has a direct impact on them. It is in their interest, and in the interest of the public at large, that the courts settle upon a consistent and fair interpretation of the law on this recurring question. This Court's authoritative guidance is needed to resolve these conflicts, and this case provides an excellent vehicle for delivery of that guidance. It presents the issues on a fully developed record and in a clear and uncomplicated factual setting. The members of NCA therefore urge the Court to grant the El Paso Company's ("El Paso") petition for certiorari.[1]

CONSENT OF THE PARTIES

Both the Petitioner and Respondent in this case have consented to NCA's filing this brief as amicus curiae. The consents have been filed with the Clerk.

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[1] The members of NCA fully support El Paso's petition and request the Court to grant certiorari on both questions presented therein. It is NCA's aim in this brief to emphasize certain points regarding the tax pool analysis issues that it considers particularly important to its interests, rather than present a comprehensive argument on all issues. Accordingly, to the extent certain arguments (or statements of fact) included in El Paso's petition are not included in this brief, NCA adopts them as stated in El Paso's petition.

THE DECISION BELOW

The facts of this case as found in the district court and restated in the Fifth Circuit's decision make it clear that the reason El Paso's tax pool analysis has been summoned is not because the company is suspected of any wrongdoing or bad faith. To the contrary, the court below took pains to note that the audit was a routine audit of the type commonly conducted by the IRS on returns of major corporations. Appendix to El Paso's Petition for a Writ of Certiorari ("App.") at 2a. The IRS made its request for the tax pool analysis at the very outset of the audit, not because material it had reviewed put the tax pool analysis in issue, but rather because, as the court below put it, the analysis "may be useful to the IRS as a 'roadmap' through [the] company's tax return," (App. 28a) thereby focusing its energies. App. 12a.

Ordinarily, as is true in El Paso's case, a tax pool analysis is not used in any way to prepare the taxpayer's return. App. 6a. It is an evaluative, not factual, document prepared to assist the company in meeting its responsibilities under the securities laws. The analysis consists of both legal and non-legal judgments of the company's tax advisers on whether certain items on the company's tax returns will be challenged on audit, whether the company should litigate or settle particular issues, the likely outcome of litigation, the amount for which the company might be willing to settle a particular issue, and similar opinions and speculations.

The analysis is generally kept confidential by the taxpayer, and the independent auditor is required by ethical considerations to keep it confidential as well. The analysis itself is never submitted to the SEC. The company preparing it, or for which it is prepared, makes public in its financial statements only the bottom-line estimate of contingent liability (assuming the amount is material).

Companies ordinarily provide the facts necessary to an IRS audit in response to specific requests from the IRS. For instance, at the time of trial in El Paso's case the IRS had made some 578 requests for documents and information needed for the audit; El Paso had complied with over 98 percent of those requests.

REASONS FOR GRANTING CERTIORARI

I. This Court Should Review the Question Whether Tax Pool Analyses Are Privileged

The Second Circuit ruled in *United States v. Arthur Young*, 677 F.2d 211 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687), that a tax pool analysis sought by the IRS from the taxpayer's independent accountant was privileged and refused to enforce an IRS summons for the analysis. The court reached its decision after carefully balancing the IRS's need for the widest possible latitude in enforcing the internal revenue laws against the policy of the federal securities laws encouraging the fullest possible financial disclosure by public companies. 677 F.2d at 220. While acknowledging the importance of the IRS's interest in a broad summons power, the Second Circuit concluded that where the information necessary to completion of its audit was available to the IRS (and fraud was not charged), the public interest in accurate financial reporting outweighed the IRS's interest. *Id.* The court's principal concern was to protect the integrity of the auditor-client relationship so that public companies would be able to present a worst-case analysis of their contingent tax liability to their auditors without fear that the IRS would later turn this analysis against them. *Id.* at 221.

To ensure this protection the Second Circuit recognized a work product privilege for tax pool analyses that prevents the IRS from summoning such analyses from a taxpayer's independent accountant. The rationale of this

work product privilege applies with equal force to tax pool analyses prepared and maintained by the taxpayer. The harm to the integrity of the auditor-client relationship is no less when the confidences sought to be protected are extracted from the taxpayer rather than his accountant. The end result in both cases is to restrict the free flow of information vital to accurate financial reporting.

Despite the applicability of the *Arthur Young* privilege to the facts of this case, the Fifth Circuit's analysis of the privilege question made only passing reference to the *Arthur Young* decision, although it did acknowledge the disparity of views in a footnote. App. 19a n.13. Despite the tentative nature of this acknowledgement, it is clear that the two decisions are mutually contradictory and hence in direct conflict. If both decisions are allowed to stand, each will completely undercut the other with the result that the law will be determined for a particular company, not by reason, but by an accident of geography.

It is NCA's position that the decision below should not be permitted to stand. The Fifth Circuit's refusal to acknowledge the seriousness of the financial reporting issue (*see* App. 28a) prevented it from properly balancing that policy interest against the interest of the IRS in free access to financial information. The court's view was that public companies are required by law to file certified financial statements; it assumed that they would comply with the law and fully disclose their contingent tax liabilities regardless of the IRS summons policy. This view, however, is directly contradicted by the current commissioner of the IRS, Roscoe Egger, and at least one former commissioner, Mortimer Caplin. Egger, as discussed more fully below, has acknowledged the very real concerns of the SEC, professionals and the public for the quality of financial reporting as a result of the IRS summons policy. IRS News Release, IR 81-49, May 5, 1981, at 3. Caplin states that "[t]he policy arguments for

limiting the Service's access to accountants' tax accrual workpapers are persuasive * * *." *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax Rev. 57, 81-82 (1981).

The Government in the *Upjohn* case made an argument similar to the Fifth Circuit's in this case. *Upjohn Co. v. United States*, 449 U.S. 383, 393 n.2 (1981). It argued that there was no public policy reason to extend the attorney-client privilege to corporate self-investigations concerning improper foreign payments because the risk of civil or criminal liability would ensure that corporations would seek legal advice on the problem regardless of whether the privilege applied. This Court observed that while investigations might continue to take place, "the depth and quality of any investigations to ensure compliance with the law would suffer." *Id.* Similarly, while corporations may be expected to continue preparing tax pool analyses, their depth and quality will suffer if the IRS continues to summon them, with consequent adverse effect on the accuracy of financial statements.

The court below has also taken the position that El Paso waived the attorney-client privilege by disclosing parts of the analysis to its independent auditor, even though the disclosure was required by law and the auditor was required to keep the information disclosed confidential. AICPA Code of Professional Ethics, Rule 301. NCA submits that such a serious limitation on an important privilege merits this Court's attention. The Fifth Circuit decision on this question also conflicts with the Sixth Circuit's decision in *Upjohn*. *United States v. Upjohn*, 600 F.2d 1223, 1227 n.12 (1979), *rev'd on other grounds*, 449 U.S. 383 (1981), providing an additional reason for this Court to review the attorney-client privilege question. The Sixth Circuit there held that partial disclosures of privileged information amount to a waiver, assuming there is a waiver at all, only with respect to

the facts actually disclosed. *Id.* Both for reasons of this conflict and of the importance of the question, this Court should grant certiorari.

II. This Court Should Review the Question Whether Tax Pool Analyses Are Relevant Within the Meaning of 26 U.S.C. § 7602

The Tenth Circuit ruled in *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977) that a tax pool analysis is not relevant within the meaning of 26 U.S.C. § 7602 under ordinary circumstances. The court set out a number of factors to be weighed in determining if a tax pool analysis should be deemed relevant in a particular case. Applying these factors, it is clear that the analysis in this case would not be found relevant under the *Coopers & Lybrand* test. The Fifth Circuit, however, rejected the *Coopers & Lybrand* analysis and determined that any information which "might shed light" on the accuracy of the taxpayer's return was relevant within the meaning of section 7602. Under this sweeping standard, El Paso's tax pool analysis, as well as almost any other financial information the company may possess, would be deemed relevant.

In addition to the direct conflict with the *Coopers & Lybrand* decision, and the less direct, but nevertheless profound, conflict with the decision of the Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973), a case presenting a relevance analysis similar to that in *Coopers & Lybrand*, this Court should review this issue because of the basic unfairness of the holding. As stated above, the IRS does not need tax pool analyses to complete its audit function; rather it seeks them for reasons of convenience and to "focus and concentrate [its] energy." App. 12a. While such concerns of efficiency are, of course, important, the IRS gains far more by summoning a taxpayer's tax pool analysis than mere information needed for completing an audit. It

learns from a tax pool analysis not only what areas the taxpayer considers fertile for review, but also what the taxpayer may accept in settlement on a particular issue, and whether the taxpayer would pursue its point of view in litigation, all without incurring any corresponding obligation to make a similar disclosure to the taxpayer. To permit one party to learn its opponent's negotiating and settlement positions in this fashion without extraordinarily strong policy reasons for so doing offends basic notions of good faith and fair play. For this reason, because of the above-noted conflicts, and because of the overall importance of the question, NCA urges this Court to grant certiorari on this issue.

III. This Case Presents the Tax-Pool-Analysis Issues in the Posture in Which They Are Most Likely To Recur

This case is unique among the circuit court decisions on the tax pool analysis issue in that El Paso's analysis was prepared completely in-house by its lawyers and other tax advisers and retained by El Paso. Consequently the IRS directed its summons to El Paso rather than to its independent accountant. In *Arthur Young* and *Coopers & Lybrand*, the other major circuit court decisions on the tax pool analysis question, the IRS had summoned the analysis from the taxpayer's independent accountant. Since the time the summonses were issued in those two cases, however, the IRS has amended its guidelines for revenue agents, articulating the circumstances in which tax pool analyses may be sought, and requiring agents to secure them from the taxpayer, rather than its independent auditor, whenever possible. I Internal Revenue Manual (Audit) (CCH) § 4024.4(5) (1981).[2]

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[2] In a speech announcing this change, IRS Commissioner Roscoe Egger noted the nationwide concern over the IRS policy of summoning tax pool analyses expressed by taxpayers, lawyers, accountants and the Securities and Exchange Commission. He said the change was made because of the potential of this policy to

As one of his reasons for seeking certiorari in the *Arthur Young* case, the Solicitor General has alluded to the frequently recurring nature of the tax pool analysis summons problem. Petition for Writ of Certiorari in *United States v. Arthur Young*, No. 82-687 at 7 (Oct. 20, 1982). Because of the change in the Internal Revenue Manual, however, it now appears that the issue will recur most frequently in the context of a summons directed to the taxpayer rather than his independent accountant. To resolve this issue fully, then, it would be best if the Court granted certiorari in both this case and *Arthur Young*. In any event, if the Court is to address the issue in the context in which it is most likely to recur, it should grant certiorari in this case, even if it does not grant it in *Arthur Young*.

CONCLUSION

For the reasons stated above, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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create "serious negative effects on the quality of financial reporting." IRS News Release, IR 81-49, Remarks by Roscoe L. Egger before the San Francisco Chapter of the California Institute of Certified Public Accountants and the Tax Section, San Francsico Bar Association, May 5, 1981, at 3. As at least one commentator has noted, however, the change in the IRS policy to requesting the analyses directly from the taxpayer only shifts the locus of the problem; it does not solve it. Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40th Annual N.Y.U. Institute on Federal Taxation 37-1, 37-14 (1981).